INTEREST RATES AND INFLATION MODELING IN INDONESIA WITH THRESHOLD VECTOR ERROR CORRECTION MODEL (TVECM) APPROACH

By : Heri Purnomo
Student Identity Number : 1309201721
Supervisor : Dr. Purhadi, M.Sc.

ABSTRACT

Interest rates and inflation is a macroeconomic indicator that is very influential on economic stability. Stable inflation affects the creation of a stable economy, so that inflation should be controlled. One way to control inflation is by determining the interest rates. In Indonesia the interest rate set by Bank Indonesia (BI) as the only monetary institution which has the authority to do so. Determination of the appropriate monetary policy will greatly influence the creation of economic stability as a whole, to determine the accuracy of a policy needed a model that can represent the condition. In modeling, this condition is divided into two regimes: extreme regimes and normal regime (regular). The separation of this region is marked by a boundary (threshold). Cointegration test results show that there is a long-term balance between the variable interest rates and inflation, so the relationship of interest rates and inflation in Indonesia can be modeled with the Threshold Vector Error Correction Model (TVECM) approach. Results showed that interest rates are influenced by the two previous periods. The balance between interest rates and inflation is running slow, reached more than 2 (two) years. Threshold obtained at 1.287% (percent).

Keyword : Inflation, interest Rate, Cointegration, Threshold, TVECM